CHAPTER 4

Aid Can Be the Midwife of Good Institutions

How can development assistance be designed so that it helps governments carry out better the activities essential to increasing growth and reducing poverty?

As the world's economies move inexorably to embrace market-friendly policies, public sectors are reorienting themselves and downsizing. "Less is better," has been the cry. But could this response go too far? In many crucial areas there are essential public responsibilities—in developing human, institutional, and physical infrastructure—that government must continue to fulfill. In these areas, less is not necessarily better, but "better is better."

One key to development is that government must do well those things that government must do. Since aid (both money and ideas) mostly supports the public sector, one pressing question is: How can development assistance be designed so that it helps governments carry out better the activities essential to increasing growth and reducing poverty? Another is: How can aid combine financial support with help to create local knowledge so that governments can improve the quality and effectiveness of public services?

Creating knowledge does not mean that donor agencies (or the experts they hire) have chunks of technical or engineering information that they simply transmit to aid recipients. In the public sector, development knowledge is needed to design and effectively run the institutions responsible for public services: primary schools in El Salvador, water supply in Guinea, road maintenance in Tanzania, or utility regulation in Argentina. This is not knowledge that exists somewhere and can be packed in a suitcase and carried to developing countries. To be effective, this is knowledge that must be created locally and internalized. Existing principles must always be adapted to new or local circumstances (or both), and developing country governments and citizens must take the lead in creating this new knowledge. Development agencies can, however, bring unique value added to the table.

A consistent focus on improving the quality of the public sector implies a radical shift in the way aid business is done—in the choice of instruments, how those instruments are used and evaluated, and how donors relate to governments and civil society.

Before choosing instruments, aid donors first need to be clear about goals.

Before choosing instruments, aid donors first need to be clear about goals. The role of aid varies depending on country circumstances; the mix of financial and nonfinancial development assistance must be tailored to specific needs. In the few poor countries where the public sector is already effective, the task of foreign aid is straightforward: simply financing the expansion of public services is likely to be both successful and beneficial. In most developing countries, however, governments are not effective at providing public services, and financing more of the same is unlikely to be successful or beneficial. In these cases foreign assistance should focus on increasing the effectiveness of core public services. This requires the right mix of finance and ideas to produce the greatest value added. Money does not usually matter most. Aid agencies must look beyond providing finance to supporting the creation of knowledge.

A combination of policy dialogue and financing is more likely to increase aid effectiveness than a narrow focus on successful implementation of aid-financed projects. At times, donors have hindered the creation of effective public sectors because they saw end runs around local institutions as the easiest way to achieve project success. Donors need to convince countries of the value of better policies and institutions rather than cocoon "their" projects from the worst consequences of those policies.

Better Public Provision

PROVIDING PUBLIC SERVICES EFFECTIVELY AND EFFICIENTLY requires that all stakeholders—governments, providers (whether public employees or private), and citizens—have reasonable incentives. These incentives can be manifold: from making governments responsive to citizens to ensuring the right structure of civil service pay, to designing concession contracts that fit country and sector circumstances.

Accountability

No longer can governments be monopoly providers of services (education, health, roads, irrigation, water, and so on) with no accountability to citizens (directly or indirectly) for their performance. In recent years donors have moved to support accountability and governance as well as innovations that support greater community "voice"and involvement. In a range of sectors these reforms carry different names and take different forms but reflect the same impetus—rural water supply ("participation"), irrigation systems ("water user associations"), schools ("decentralization" and "school autonomy"), transport ("road management boards"), health ("community associations"), and environmental management ("community forestry").

Donor finance can affect accountability and the quality of public services for good or ill.

Donor finance can affect accountability and the quality of public services for good or ill. In the irrigation sector examples abound of how an emphasis by governments and donors on quantitative (or investment) targets and modern technologies led to the exclusion of the intended beneficiaries from planning, design, and implementation. Sometimes that exclusion can lead to almost absurd results. One major donor-financed irrigation system in Nepal was designed by technical staff on the assumption that the area was unirrigated (Ostrom 1996). A fortuitous delay in the project provided the time to discover that, in fact, there were 85 fully functioning farmer-managed irrigation systems. Beneficiary involvement would have saved red faces. Another Nepalese irrigation scheme actually lowered agricultural productivity by undermining preexisting arrangements among farmers (Hilton 1990, 1992).

A recurring problem with irrigation projects has been inadequate revenues for operations and maintenance. Merely raising water fees does not solve the problem unless providers are accountable and the necessary revenues are devoted to maintenance. Even when revenues are available for maintenance, the organizational structure of the provider can be a problem. One study compares irrigation systems in India and the Republic of Korea (Wade 1995). While the two systems are similar, the different design of their irrigation departments (responsible for delivering water) leads to enormous differences in performance. In India the department is a centralized bureaucracy that relies on general treasury revenues for finance; in Korea irrigation officials are local and in constant contact with farmers.

Such problems are not unique to irrigation, but plague service delivery in many other sectors—water supply, health care, education, road maintenance—due partly to the way aid projects have been structured. The emphasis on increasing the quantity of financial aid as the answer to increasing growth has led agencies to targets that centered on the size and speed of disbursements and a technocratic approach to the design of investments. Even when all parties know better, "moving the money"can easily and quickly become the paramount institutional objective (Tendler 1975). With that kind of thinking, agencies opt for large projects rather than small ones and prefer to deal directly with centralized agencies on efficiency grounds (box 4.1). Doing so makes accounting and administration easier. In many cases donor investment projects—with fixed schedules and budgets—have left no room for beneficiary involvement. In some cases this led to "approval cultures" in aid agencies, where success was judged by the volume of disbursements (World Bank 1992).

Reviews of the Danish donor agency's 30-year experience in Tanzania's rural water sector found that the same problems (lack of maintenance, low community interest) occurred repeatedly, yet only modest changes were made in project design. The agency's procedures were dictated by a need to implement projects rather than to create supplies of water that met the needs of beneficiaries. A review of the World Bank's irrigation experience suggests that although the benefits of user participation are large, "irrigation professionals are wary of such participation, because they know it will lengthen the implementation period"(Jones 1995, p. 141).

Some measure of the importance of beneficiary participation in project success can be gleaned from an evaluation of 121 rural water supply projects financed by donors and nongovernmental organizations in 49 countries (Narayan 1995; Isham, Narayan, and Pritchett 1995). As

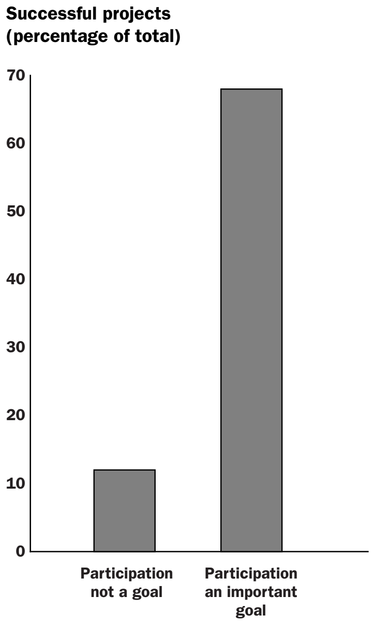
Box 4.1 Aid and Centralization

"Strengthening the role of local governments, especially in the delivery of public services—for example, health, social welfare, agricultural extension, and rural infrastructure provision, all of which have all been devolved in the Philippines—is intuitively desirable. But in practice decentralization has led to problems in the formulation of donor projects. The problem does not arise so much in the case of grant assistance as in loan-funded projects, where the question of loan conduiting can become a stumbling block. Donor agencies are not normally prepared to lend directly to local governments without a guarantee from the national government. But providing such a guarantee runs counter to the principle of devolving responsibility to the local government. In the absence of satisfactory loan conduiting mechanisms for local governments, national government agencies tend to formulate projects that involve devolved functions, undermining the devolution process" (Habito, in OECF/World Bank 1998, p. 21).

shown in the overview among projects with a high level of participation, 68 percent were highly successful. But of those projects in which there was little beneficiary involvement, only 12 percent were highly effective. Another important finding was that not only was participation crucial to success, but also that it could be encouraged, or discouraged, through project design and government action. Implementing agencies which actively sought to involve intended beneficiaries had 62 percent of their projects achieve success (figure 4.1). In contrast, government agencies that did not actively seek beneficiary involvement ended up with less effective projects and only 10 percent were highly successful.

When agencies sought participation as a goal, 62 percent of projects were successful—when not, only 10 percent.

Figure 4.1 Participation and Project Success



Source: Isham, Narayan, and Pritchett 1995.

Another study found that investment projects have been more effective in countries where citizens enjoy civil liberties (Isham, Kaufmann, and Pritchett 1997). This is not a measure of political democracy but of people's freedom to express their views (free press, freedom of association and assembly, freedom to petition governments). Civil liberties matter even among projects assessed on the economic rate of return—projects that might be thought to be entirely technocratic matters for engineers and economists and insulated from popular pressures (appendix 4). Indeed, the probability of a project failing (those with *ex post* economic returns below a cutoff of 10 percent) is 50 percent higher in countries with fewer civil liberties (figure 4.2).

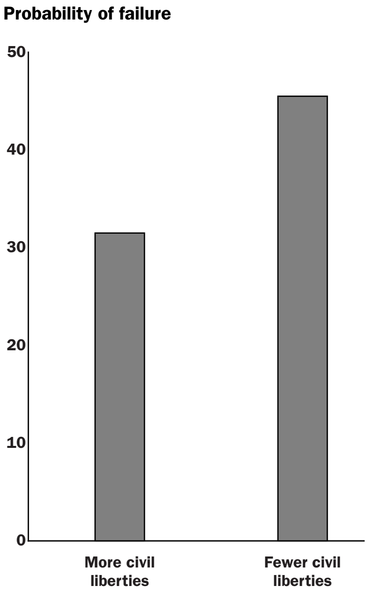
Donors are moving to encourage beneficiary involvement and local ownership. To that end, they have embarked on numerous innovations, including social investment funds. These funds do not specify a particular set of projects by sector (a road project, say, or new schools in particular villages). Instead, they specify processes whereby communities can apply for funds for any project they wish to undertake, subject to reasonable conditions on cost, need, sustainability, community contribution, and so on. Such funds have been created in more than 20 countries, and a preliminary evaluation suggests that they have been reasonably successful. They force changes on donor agencies from project to process: the fund must specify a process for funding projects and assess the likelihood that this process will produce projects that generate sustained benefits. But the evaluation found that even social funds maintain features that are an end run around institutional weaknesses and hence are only a temporary solution.

Donors are also becoming more flexible about allowing midstream adjustments in projects and encouraging "structured learning" so that development objectives are met. An example is the World Bank's support to Brazil's PROSANEAR sanitation project. Sponsored in part by Caixa

Economica Federal, this project uses an effective sewage collection strategy. "PROSANEAR boasts a high degree of community participation and shared responsibility. Communities are increasingly involved in monitoring household use and system performance, and in managing their own repairs. The project's most striking feature is Caixa's commitment to adjust design and works according to the lessons of experience" (World Bank 1995a, p. 6).

Civil liberties matter for economic projects.

Figure 4.2 Civil Liberties and the Probability of World Bank Project Failure



Source: Isham, Kaufmann, and Pritchett 1997.

Public Sector Compensation and Performance

The approach to aid that emphasized the quantity of investment and technocratic skills tended to underestimate the power of incentives in determining the actions of public sector providers. In the past donor and government technocrats assumed that once power plants were built, they would be operated effectively; new roads would be maintained; health clinics, once constructed, would provide quality services. In reality benefits will flow only if there are adequate incentives for (mainly civil service) providers. Both bilateral and multilateral donors now recognize that incentives are crucial for success and have been providing support for reforms in public sector management and the civil service.

Many poor countries have found it hard to maintain a competent, efficient, and honest civil service because real public sector wages have tumbled in the past 15–20 years. Underpaid (but not especially overworked) and with their morale at rock bottom, civil servants, especially high-level ones, have turned to moonlighting and corruption (World Bank 1995b). By 1986 the real average wage in Tanzania, for example, had fallen to a fifth of its 1969–77 value. The wage of top civil servants had fallen even further: to just 6 percent of its previous level. The ratio of top level pay to the minimum wage was only five to one. Pay is not always the problem. Even in countries where civil service pay is adequate, the structure of incentives is not. Guarantees of job tenure and lockstep pay rises based on seniority encourage none but the workaholic.

Especially in poor and aid-dependent economies, donors have sometimes done more harm than good. In their efforts to attract the best people for projects, donors can unwittingly deplete the civil service of its best and brightest, offering salaries and working conditions that governments cannot match. An independent study reported that for an agriculture project in Kenya the World Bank hired eight local people at salaries of \$3,000–6,000 a month; of the eight, all but one was recruited from the civil service, where the monthly salary for a senior economist was roughly $250. In Mozambique international organizations were paying five times the civil service wage for professional staff and 10 times the civil service wage for technicians (Fallon and Pereira da Silva 1995). The combination of low civil service salaries and competition for skilled personnel among donors makes the strengthening of the civil service through training a Herculean task. Workers leave as quickly as they are trained. One program in Kenya funded by the Canadian International Development Agency trained 13 economists to the master's level; within a year, 10 had found jobs outside government, and the other three were searching (van de Walle and Johnston 1996).

When donor-financed projects fail, it is often because of weak institutions and public organizations.

Civil service reform, too, often denudes the public sector of its most competent staff. Reforms usually include downsizing (jargon for eliminating redundancies). When this is "voluntary"(employees are offered a severance package, usually more generous than mandated by law), the most skilled are the first to leave. But downsizing does not have to be a problem. In 1991 Peru announced two staff reduction packages for its civil service. One was an across-the-board offer taken up by 250,000 workers, of which 163,000 had to be rehired later. In contrast, the downsizing in tax administration targeted employees by skill level and was able to reduce staff by two-thirds while raising wages and doubling tax revenue (Haltiwanger and Singh forthcoming).

Effective Public Institutions

When donor-financed projects fail, it is often because of weak institutions and public organizations. There is plenty of evidence that institutional capability affects overall economic growth and the success of investments. One recent study found that over the 30 years to 1994, countries with sound policies and capable and effective government institutions grew at 3 percent per capita each year—while those with sound policies but weak institutions grew at only 1.4 percent a year (World Bank 1997a).

Using an index based on various dimensions of government performance, a recent staff review of World Bank–financed projects found that, whereas the average success rate on Bank projects was 68 percent, projects in countries with sound policies and capable institutions had an 86 percent success rate. Countries with neither sound policies nor able institutions had failures in 52 percent of projects, nearly four times the rate in countries with good policies and governance (see overview figure 5).

The design of projects needs to adjust to the reality that money or capital stock is less important than good institutions or better ideas.

This study concludes that: "in settings where policies and institutions are seriously weak, the Bank would do best to focus on policy-based lending and non-lending services that support the strategic policy-making and implementation capacity of government"(World Bank 1997a, p. 13).

Would better-designed official development assistance mean more effective public institutions? Because aid has gone almost exclusively to (or through) central governments, it has affected how public services are delivered. In general, government-provided services are those that are difficult to allocate via markets, either because they are pure public goods that benefit all (national security, rule of law) or because they involve external effects that are hard to value (health services, environmental protection). The nature of these services, however, implies problems in designing lasting institutions and incentives for efficient public sector delivery and performance.

In the interests of effective implementation, donors often establish quasi-independent project implementation units outside the line ministry (and sometimes outside the government). Donors do this to "cocoon" the projects they finance from the worst inadequacies of the public sector. When projects are "successfully"concluded and turned over for operation to the regular line ministry, they lack the commitment, competence, and resources needed to continue. While isolating projects can at times make sense for purposes of piloting, demonstration, or evaluation, narrowly measured implementation "success" that comes at the expense of institutional capacity building generally is a Pyrrhic victory and inimical to the true success of aid.

The design of projects needs to adjust to the reality that money or capital stock is less important than good institutions or better ideas. The point of an education project is not to increase funding for the sector (this can be done without projects) but to help reformers change the ideas, institutions, and policies in the sector. A truly effective project is a bundle of activities that does not just build schools but, more important, helps to change how schools are run to provide high-quality education. Building the finest schools, hospitals, or roads is pointless if the institutional capacity does not exist to maintain and run them.

This means that the most useful projects will often be innovative. If a country is competent at building schools and running them, donors should simply provide general budgetary support. The only rationale for a project is that things should be done differently than they are now. If existing schools are ineffective, a useful project might rehabilitate them and help alter institutional arrangements (for example, increasing community input into decisionmaking). Such a project may draw on things that have worked elsewhere, but it is innovative in the setting where it is being implemented.

An important corollary is that the success rate of financed projects is not particularly relevant—if success is narrowly defined. An effective agency may finance a lot of innovative projects, and some of these may "fail"—in the sense that they do not lead to better services. The important question is whether developing countries are systematically gaining knowledge from such experiments. Failed projects can often teach as much (or more than) successful ones. If projects are deemed "successful" because they merely replicate past success, agencies have the wrong incentives to provide effective assistance. Managers will want to avoid risky, innovative projects in favor of things that are known to work. This leads to unseemly and counterproductive competition among donors to "skim the cream" and finance only those items in the public investment program that are likely to be successful—with or without donor involvement.

If projects are deemed "successful" because they merely replicate past success, agencies have the wrong incentives to provide effective assistance.

In response, donor agencies have moved to broader measures of project success. They typically assess the effect of projects on the institutional capacity of sector agencies. Take a road project. Are better technologies for designing and building roads being introduced? Will pricing and other policies ensure maintenance? Are agency staff receiving necessary training? Assessing whether there is a "substantial institutional effect" is essentially asking a host of questions about whether the project is helping the recipient country to change the way that it manages its road sector.

Note that a project could have a successful "outcome"—the road is built and has a high return—but no lasting effect. On the flip side, a project could have "failed" but have led to substantial institutional development. This is particularly true of innovative approaches to service delivery, to which a lot of aid now goes. The innovative approach may not work, but if it is systematically evaluated and the knowledge is fed into a broader reform program, the project is helping improve the management of the sector.

This kind of serious impact evaluation has often been missing from development assistance, yet it is potentially of the greatest value. Again, innovations may fail, but development assistance is strengthening the underlying institutions by assisting in the design and evaluation of new approaches and generation of knowledge. Increasingly, donors are emphasizing the crucial importance of this kind of knowledge creation. Witness the United Kingdom. A recent White Paper on International Development says:

> "Research is an important weapon in the fight against poverty. Without research, many development interventions would fail or be much less successful; and research has significant multiplier effects—solutions to the causes of poverty in one part of the developing world may well be replicable in another. The principle of shared knowledge is an important component of the partnerships which are essential to development. The Government sees the continued investment in knowledge generation as a key element in achieving its aims and objectives for international development" (U.K. White Paper 1997, p. 48).

Without research, many development interventions would fail or be much less successful.

At the World Bank, each completed project is rated on the basis of whether it had a "substantial institutional development impact,"and this is viewed as the "most important evaluation criteria for long-term development effectiveness"(World Bank 1997a, p. 24). However, this component is also difficult. For a long time the share of World Bank–financed projects with a "substantial"institutional impact hovered around 30 percent, and only in recent years has it climbed to 39 percent. Thus it is possible for development projects to help change significantly the way the public sector does business. But it still happens in too few cases.

In our view, an effective development agency will be taking risks, systematically evaluating the outcomes, and disseminating the knowledge gained. This generation and dissemination of knowledge is one of the biggest contributions that development assistance can make. In tandem with the old rationale for aid, in which donor financing addressed market failure in capital markets, donor activities need to address the market failure in "knowledge" markets (Stiglitz 1988). But serious, rigorous evaluations that generate solid knowledge are expensive, and no one government has the incentive to undertake evaluations that will benefit other countries.

Public Provision without Public Providers

TO MAKE AID MORE EFFECTIVE, DEVELOPING COUNTRY GOVERNMENTS are increasingly turning away from the traditional (and exclusive) use of public bureaucracies to provide services. Many public services can be provided effectively (often more effectively) by private organizations under contract or holding a concession. Donors and governments have often turned to nongovernmental organizations. New sources of financing have also brought about important changes in providers' incentives, empowered intended beneficiaries, and so increased the effectiveness of aid.

Many public services can be provided effectively (often more effectively) by private organizations under contract or holding a concession.

Contracting and Concessions

Privatizations and divestments have reduced the drain on government revenues and capacity in areas where public sector involvement is not critical. But even when government retains responsibility for services, they need not be managed through the usual public sector agency. Many activities can be contracted out to the private sector, and competition among potential providers can create pressures for cost-effectiveness.

How does it work? Take AGETIPs (Agences d'Execution des Travaux d'Interêt Public), not-for-profit associations that enter into contractual arrangements with governments to carry out infrastructure projects. The first was in Senegal, which (by contracting with individual suppliers through open bids) was able to reduce costs and delays. Other West African countries soon adopted this model (World Bank 1997c).

A concession is a way to contract with private providers for the provision of services without relinquishing public ownership of assets or public control of service delivery conditions. In Guinea a contractual arrangement under which a private management agency took over the operation of a water system was set up with the help of an International Development Association loan that initially paid the difference between costs and the revenues recovered from users. The subsidy was gradually reduced and the operation is now run commercially. This shows how aid can smooth the introduction of new arrangements. As important, donors can relay positive (and negative) experiences to other aid agencies and countries contemplating similar arrangements—be it power deregulation in Chile, water concessions in Argentina, or toll roads in Mexico.

Disseminating experience and lessons from innovators is especially important in improving the effectiveness of aid. Take railways, a clear example of diffusion of information about innovations in management. In developing countries railways are often run down and costly, with outdated rolling stock—all thanks to inefficient public management and competition from roads and airlines. Argentina was an innovator in railways. It split its massive federal system into several freight and commuter rail networks and awarded the rights to run them to private firms, sometimes through "negative" concessions (where firms bid the lowest amount the government would have to offer them in subsidies). While some of these concessions have had problems, labor productivity quadrupled, prices fell, and the public sector saved $600 million (Thompson and Budin 1997). More important for aid, development agencies helped ensure that the pitfalls and pluses of Argentina's experience were incorporated into programs in Brazil, Chile, Mexico, and countries in Africa, which have all moved to concession railways.

NGOs as Service Providers

The use of nongovernmental organizations (NGOs) as implementing agencies for donor-financed projects is another rising trend (box 4.2). Many NGOs also receive government contracts to provide services.

NGOs have advantages in providing some services, over both government agencies and more profit-oriented suppliers. NGOs can often reach local and target groups more effectively than can traditional government agencies. But NGOs are no cure for the shortcomings of the public sector. Moreover, external NGOs often have the same problem as donors in

Box 4.2 A Useful Surge in Nongovernmental Organizations

A RECENT REPORT BY JAPAN'S OVERSEAS ECONOMIC Cooperation Fund (OECF) notes that "the spread of democracy and the broader political participation that has come with the end of the Cold War has stimulated NGO activity throughout the world. The governments of both developing and industrial countries have a relatively good understanding of the large role that NGOs can play in a country's development. The OECF has collaborated with local NGOs on preimplementation studies and project implementation for several projects, including the Aravalli Hills Afforestation Project in India and the Forest Sector Project in the Philippines. It has also commissioned a Japanese NGO, the Japan Wild Bird Society, to conduct an environmental survey on the habitat of cranes as part of the OECF's special assistance for project formation for the Development Project of Agriculture on State Farms in Heilongjiang Province in China (Sanjiang Plain). For the Jamuna Multipurpose Bridge Project in Bangladesh, a local NGO is conducting the basic survey on site expropriation. There have also been numerous instances in which local and international NGOs have contributed valuable advice on sector surveys, preimplementation studies, and project appraisal and implementation" (OECF 1996, p. 60).

creating sustainability and local ownership (World Bank 1998 a). So, while NGOs can be part of the service delivery system, they cannot replace government and cannot be a permanent substitute for public sector capacity.

User Fees, Effectiveness, and Demand-side Financing

In recent years donors have financed innovative ways to increase service effectiveness.

Government services (particularly those financed by aid) are often provided free to users—health care, irrigation, water, extension services, schooling, roads, and so on. In many cases this approach is socially desirable but raises three problems—two serious, one less so. Least important, free services tend to be overused, clogging the system—be it a road network or health clinic. The two more severe problems are institutional and closely related to aid. First, since the service does not generate revenues, its provider depends on the general treasury for funding. Especially in poor countries with chronic or recurrent fiscal crises, that is cold comfort. There is little assurance that funds needed for, say, medicine or irrigation maintenance will be forthcoming. Second, because funding comes from the treasury, it is difficult to empower beneficiaries or instill in them the sense of ownership so necessary for the success of aid projects. Users are frozen out, in setting priorities and planning and delivering services.

In recent years donors have financed innovative ways to increase service effectiveness by creating charges directly linked to improvements in quality —from irrigation to education, health to agriculture. Health is a good example. Providing universal health care in poor countries is a laudable aim. But because of insufficient funding, morale is in the depths, and more important, clinics often have no needles, drugs, or medicine. That leads to a vicious cycle: patients, knowing the poor quality, seek care elsewhere, leading to underuse of clinics, which makes it harder to justify increased budgets to improve services (Filmer, Hammer, and Pritchett 1998).

In 1988 the Bamako Initiative sought to reverse that cycle by introducing user fees in Cameroon. A project financed by the U.S. Agency for International Development carried out a controlled evaluation of the combination of charging user fees and using them to improve quality by creating a reliable drug supply. The study found that not only did the use of health centers increase but that there were proportionately more poor users than rich (Litvack and Bodart 1993). Similar experiments have had similar results in other sectors, such as education (Birdsall and Orivel 1996). Examples like these reveal the valuable role donors can play in financing and evaluating innovations in service delivery.

Making Aid Work for Better Public Services

The shift in development thinking requires reorienting the instruments of aid.

THE SHIFT IN DEVELOPMENT THINKING FROM A GOVERNMENT-LED accumulationist strategy to a focus on fundamentals, effectiveness, and efficiency in core public sector responsibilities requires reorienting the instruments of aid. In particular, it means reconsidering the methods of financial (project and program) and nonfinancial (technical assistance, policy analysis, training) assistance and how they can be adapted to support the new development strategy.

Project Finance

We have not yet discussed a topic that accounts for most of the analysis of aid effectiveness: the technical and administrative details of making aid projects more effective. There are two reasons for this. First, and most important, this area has been well covered in many past evaluations, reviews of experience, and research, and we have little of value to add. Many donor agencies review the performance of completed projects. The combination of individual project experience and comparisons across countries allows these evaluations to provide critical and constructive suggestions from the lessons learned to improve the organization's operations. In addition, some donor agencies' technical departments and evaluation departments produce sector specific reviews of both the problems faced and promising approaches in each sector.[1] This voluminous literature on project performance and sectors provides a wealth of information needed to implement successful projects.

The second reason that we do not go further into the issue of effective aid projects is that we are more interested in the indirect than the direct effects of projects. Aid-financed projects can have spillover effects from individual projects to the general operation of the public sector.

Almost from the beginning, projects financed by foreign aid were thought to have important indirect and broader benefits. Hirschmann (1967) argued that perhaps the greatest were institutional and personal learning from the conception, planning, and implementation of projects. He believed that projects were the "privileged particles" of development that created innovation by confronting problems as they arise. These benefits emphasize the value added of donor involvement, which allows a supportive "infrastructure" of institutional and technical support for implementation that would otherwise not be present.

Development projects can be a testing ground for ideas or concepts that are new to a country, demonstrating to the government and citizens what does (or does not) work—contracting out public services, using NGOs, involving user groups in management, and so on. The value added of donors is twofold. One is the ability to devote resources to careful evaluation of experience. Knowledge of this type is an international public good, and no government has sufficient incentive to evaluate or disseminate it. Donor projects can also help break the mentality that locks the public sector into ineffective arrangements. Reform-minded governments find it hard to implement new ideas—especially those that challenge entrenched interests, particularly if there is no guarantee that they will work. That they will work can often only be proven by implementation. Donors can break this vicious circle by helping to implement such projects. In a joint meeting of officials of the Gambia and the World Bank to improve the working relationship, the Gambians expressed "the importance of the Bank's role in bringing experience and ideas from outside as the strongest plank in the partnership. Financing was vital, but more because it represented the possibility to do—moving beyond talk" (Marshall 1997, p. 26).

Development projects can be a testing ground for ideas or concepts that are new to a country.

But the benefits depend on the project being implemented in a way that is different and on the evaluation of this difference. Unfortunately, both of these requirements are rarely met, as donor-financed projects often do not provide mechanisms for rigorous evaluation of outcomes—or did not until recently.

Projects also present opportunities to engage in a sectorwide dialogue with government. Many investment project failures are linked to sector policies of government that often conflict and work at cross-purposes. For instance, in some countries agricultural extension, irrigation, and transport projects intended to encourage farmers to grow specific crops have been overwhelmed by macroeconomic and microeconomic policies that effectively resulted in heavy taxation on agriculture. In other countries investments in roads, irrigation, and other infrastructure have been poorly maintained (or not maintained at all) because public agencies could not recover costs and were starved of funds. Changes in general policies that result from dialogue improve the sustainability of donor-financed projects and improve prospects for all projects in the sector. This effect can be crucial value added from donor involvement.

Just one example comes from the difficult area of resettlement caused by land acquisitions in public investments (see box 4.3). Because projects can have both a direct impact (a new road links communities, carries people and freight) and spillover benefits (improving institutions and sector policies), both need to be evaluated.

Nonproject Finance

Donor financing that is tied less to the implementation of particular projects—such as program aid, sector investment financing, sectoral adjustment programs, or other time-slice finance instruments—has advantages and disadvantages over project finance.

In a country where spending allocations are sound and the effectiveness of expenditures is high, the potential value added of donor involvement in project design and implementation is minimal. Nonproject financing saves on project preparation and implementation costs, both for donors and recipient governments. One scarce resource of donors is staff with technical skills and experience from a range of countries. Since project preparation is staff intensive, however, using projects as a form of support in well-managed countries does not necessarily allocate staff where their skills are best used or needed. Scarce skills will probably be put to more productive use elsewhere. For recipients, nonproject assis-

Box 4.3 Resettlement in Development

A comprehensive review of the World Bank's experience with implementing its resettlement policies in its projects concludes that:

"Having been the first international development agency ever to adopt a resettlement policy, the Bank has promoted this policy with the Borrowers whose projects include involuntary population displacement. One main result of the Bank's catalytic impact 1986 to 1993 is that several Borrowers enacted or improved domestic policies and legal frameworks for resettlement.

"Resettlement works when governments want it to work. The main way governments express their commitments to good resettlement is by creating adequate institutional capacity, defined as the synergy between policies, organizations, and resources. When borrowers do not genuinely concur with the Bank's resettlement policy from the outset, resettlement is generally not carried out well—regardless of Bank missions or the frequency of Bank threats to suspend disbursements.

"The Bank has been far more effective overall—and immediate operations have benefited more—when it in reached agreement with borrowing governments on the broad domestic or sector policy framework relevant to Bank-assisted operations, than when its efforts were confined to legal agreements for individual projects. In turn, the obligations it laid down in individual loan legal agreements and the agreed "project policy" have sometimes formed the basis for discussing and improving more general domestic legal and policy frameworks" (World Bank 1996a, p. 8).

tance helps with donor coordination. The administrative setup needed to monitor perhaps hundreds of donor-financed projects is burdensome to governments with limited public sector management capability. Often each donor and each project has its own procedures, plans, and reporting and procurement requirements.

Project financing brings its own biases into the incentives of aid agencies: favoring investment over recurrent spending, large projects over small ones, expansion of physical production over improvement in efficiency, imported materials over domestic. Recipients often see projects as being generated and implemented by aid agencies alone, with little local ownership.

Project financing brings its own biases into the incentives of aid agencies: favoring investment over recurrent spending, large projects over small.

The use of general budgetary support delinks projects and implementation from overall targets for assistance—that is, the size of projects is often scaled to meet targets for total assistance disbursed rather than to maximize the value added of projects. At times the scale of the project works at cross-purposes with its intent.

But all of these considerations apply mainly to those lucky few countries and sectors in which public services are already effective and, perhaps, even efficient. If one of the main concerns of development is to improve policies and increase government's institutional capacity (and it should be), foreign assistance that simply expands the budget envelope of existing activities without changing the structure or incentives for service delivery is unlikely to see much of a payoff. The question is: What kind of support will best lead to public sector improvement? Sometimes projects are necessary. At other times a policy dialogue—connected to program assistance—is needed. And sometimes no financing at all is the most useful.

An excellent study of aid in Africa sponsored by the Overseas Development Council, based on collaborative case studies in seven African countries, makes this recommendation:

> "[Program aid] is not likely to promote development in the absence of sound economic policies. In such situations, donors should maintain a policy dialogue with the government, but limit aid flows and direct them to project assistance, often focusing on non-state actors. When sound economic policies have been put in place, donors should expand program aid, perhaps in the context of sectoral investment strategies negotiated with the government"(van de Walle and Johnston 1996, p. 8).

This recognizes the complex factors in the choice of the method and level of development assistance. Effective aid depends not just on the type and method of aid chosen, but critically on government policies, institutional capability, and commitment to improve services.

A society (or government agency) that has generated its own reform program is receptive to technical assistance and institution building.

Nonfinancial Support

Nonfinancial support can have a high payoff, but its record has been mixed. Lack of institutional capacity in developing countries has long been recognized as a big hurdle to development.[2] One traditional solution has been to use three types of technical assistance: employing foreign experts on a short- or long-term basis, training government officials (in country or abroad), and financing long-run educational programs. While donors have made much use of foreign experts to improve institutions (and there have been successes) the overall results have been disappointing (World Bank 1996b). A United Nations Development Programme evaluation in 1993 suggested that "there is a growing sense that technical cooperation does not work well, that as presently practiced it is ineffective, that such benefits as it brings are extremely costly, and that in any case it has little lasting impact" (Berg 1993, p. 3–4).

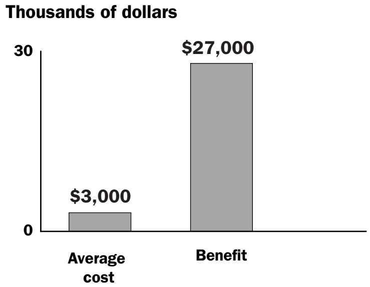
A society (or government agency) that has generated its own reform program is receptive to technical assistance and institution building. When not driven by domestic demand for particular expertise, however, foreign experts are often not integrated with ministries in a way that allows knowledge to be transferred. Free-standing technical assistance provided by international consultants and individual technical experts has served some purposes, but as a way to promote and improve public sector institutions they have usually been expensive failures.

Training government officials in technical tasks has also had mixed results. In many countries training has been unsuccessful because public officials do not have the incentive to perform, are politically blocked from performing, or do not have the materials or resources to perform. In many countries there is no way to speed up the slow process that involves creating not just the capacity for policy analysis and dialogue (both in government and civil society) but also the demand from recipient governments for productive technical assistance. The impact of ideas is difficult to monitor, evaluate, and especially quantify because the ways in which policy analysis contributes to future performance are often intangible and indirect.

One study undertook an empirical analysis of World Bank projects (mostly approved in the 1980s) to investigate the relative contribution of two staff inputs (Deininger, Squire, and Basu 1998). One is the input directly related to the project—preparation before the project begins and supervision while the project is being implemented and the finance is being disbursed. The second is "economic and sector work,"which produces reports on the economy and particular sectors for government but also covers the dialogue with government and other development agencies.

The payoffs for analytical work can be enormous.

Figure 4.3 Cost and Benefit of an Additional Week of Analytical Work



Source: Deininger, Squire, and Basu 1998.

The study found that (even after controlling for country, sector, and economic conditions and staff preparation and supervision for a particular project) prior analytical work improves projects. On average these activities have a high payoff, as the benefit of one additional week of analytical work by the World Bank is nine times the cost—including staff time, travel, and overhead (figure 4.3). Moreover, since analytical work affects many projects, the overall benefit is even larger. And these are just the payoffs to projects financed by the Bank. If the changes made from policy analysis affect other donor-financed projects, or perhaps even all government projects, the returns to involvement in nonlending activities would be enormous.

While analytical work has a high return, the same authors found that the World Bank underinvested in it, and overinvested in resources dedicated to ensure that a steady stream of projects went to the Executive Board (appendix 5). According to their estimates, a shift of resources from project preparation to analytical work would have led to lower commitments but a higher success rate of projects. In other words, fewer projects would have been approved, but they would have been better designed and better implemented. Ironically, a shift of resources from project preparation to analytical work would have led to higher—not lower—disbursements of funds. The reason is that problem projects are implemented slowly and hence disburse slowly.

Methods of Assistance and Public Sector Efficiency

Properly managed, aid can encourage better public sectors through both project and nonproject activities (and often through a combination of the two). Both can provide the knowledge countries need. Projects support experimentation and reform, demonstration, piloting, evaluation, and innovation. There are also several ways in which donors can assist countries through nonproject activities, such as by creating and diffusing

Properly managed, aid can encourage better public sectors through both project and nonproject activities.

information drawn from their experience. Since aid agencies implement many projects in different countries and with different institutional structures and have an established capacity to evaluate projects, they can draw on cross-cutting evidence and experience that no single country could. Policy analysis, bringing technical expertise to bear, can be useful. Training—that is, enabling domestic actors with the necessary capabilities to accomplish their objectives, whether by exposing policymakers to other experiences or providing new skill—also plays a key role.

Notes

1. Even a partial list of the literature produced by just the World Bank gives some indication. From the Operations Evaluation Department have come reviews of, among other sectors, irrigation, agricultural extension, and adjustment lending. Sectoral policy papers reviewing the experience with Bank involvement have been produced on, among others, energy, water, education, and adjustment lending.

2. Krueger, Michalopoulos, and Ruttan (1989) note that in the 1950s the U.S. Agency for International Development was home to a huge debate between advocates of capital assistance and advocates of technical assistance.